



STATE BOARD OF EQUALIZATION STAFF LEGISLATIVE BILL ANALYSIS

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| Date Amended: | 03/13/01 | Bill No: | AB 7 |
| Tax: | Sales and Use | Author: | Cardoza |
| Board Position: | | Related Bills: | AB 13 (Florez) |

BILL SUMMARY

This bill would provide a five percent sales and use tax exemption for sales and purchases of farm equipment and machinery, as specified.

ANALYSIS

Current Law

Under existing law, the sales or use tax applies to the sale or use of tangible personal property in this state, unless otherwise exempted or excluded by statute. Under current law, the sales and use tax applies to sales and purchases of farm equipment, including tractors, to the same extent as it applies to any other sale of tangible personal property that is not otherwise exempted or excluded from tax by statute.

The Sales and Use Tax Law provides some exemptions related to the agricultural industry, as follows:

- Tax does not apply to the sale or purchase of any form of animal life or seeds and plants of a kind, the products of which ordinarily constitute food for human consumption (e.g., sales or purchases of cows, bees, chickens, strawberry plants, and citrus seeds are exempt from tax).
- Sales or purchases of feed for “food” animals and fertilizer for “food” plants are exempt from sales and use tax.
- The sale and purchase of drugs and medicines administered to animals as additives to feed or drinking water are exempt if the primary purpose is to prevent and control disease of “food” animals or of animals which are to be resold.
- Other drugs and medicines, the primary purpose of which is the prevention or control of disease, that are administered to “food” animals are exempt.

This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the Board’s formal position.

Proposed Law

This bill would add Section 6356.5 to the Sales and Use Tax Law to exempt from the State's General Fund portion of the sales and use tax (5%) sales and purchases of farm equipment and machinery, and the parts thereof, used to produce and harvest agricultural products.

The bill would become operative on the first day of the calendar quarter commencing more than 90 days after the bill becomes effective.

Background

There have been several bills considered in the recent past to provide a partial exemption for sales of agricultural-related equipment. These include:

AB 3089 (1993-94) which would have provided a five percent sales and use tax exemption with respect to tangible personal property purchased by new businesses engaged in the production of food, fiber, and other agricultural commodities. This bill failed passage in the Assembly Revenue and Taxation Committee.

AB 208 (1995-96), similar to AB 3089 above, was amended in the Assembly Revenue and Taxation Committee to delete these sales and use tax provisions.

AB 138 (1997-98), also similar to AB 3089 and AB 208, died in the Assembly Appropriations Committee.

SB 38 (1997-98) would have provided a five percent sales and use tax exemption to sales of implements of husbandry to new businesses engaged in agricultural production or agricultural services. This measure failed passage in the Senate Revenue and Taxation Committee.

SB 818 (1999-00) would have would have provided a five percent state sales and use tax exemption for tangible personal property purchased by new businesses for use in post-harvesting activities of agricultural commodities. This measure failed passage in the Senate Revenue and Taxation Committee.

COMMENTS

- 1. Sponsor and purpose.** This bill is sponsored by the author and is intended to provide an exemption for the farming industry in conformity with other states. According to the author's office, California is one of only four states that currently imposes a sales and use tax on farm equipment.

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2. **What is farm machinery and equipment?** In order to avoid any ambiguity in administering the proposed exemption, it is recommended that a precise definition for “farm equipment and machinery” be provided in the bill. For example, absent a definition, the term could include such items as a shovel purchased by an individual to plant strawberry plants for personal consumption, an aircraft used for crop dusting, or gardening gloves.
3. **What about equipment that has a dual purpose?** The proposed exemption would apply only to farm machinery and equipment used to produce and harvest agricultural products. The bill doesn’t specify, however, whether the equipment must be of a type ordinarily used to produce and harvest products, or whether the equipment must be used exclusively or primarily in harvesting or producing agricultural products. As a simplified example, it could be argued that a sprinkler purchased to water both the lawn and herb garden constitutes equipment used to produce agricultural products.
4. **Should the bill be limited to purchasers engaged in the business of farming?** As currently drafted, any individual who purchases farm machinery and equipment for personal use would benefit from the proposed exemption. In order to be consistent with the intent of the bill as we understand it, the author may wish to amend the bill to limit the exemption to persons engaged in the farming business. Without that amendment, the revenue loss associated with this measure may be greater than anticipated.
5. **Partial exemptions are difficult for both retailers and the Board.** If this bill is enacted, retailers of farm equipment and machinery would be required to program their registers to compute only the applicable local and district taxes on their sales of farm equipment and machinery. In addition, they would have to segregate in their records sales subject to the partial exemption, sales with a complete exemption (such as the sale of a strawberry plant), and sales that are fully taxable. This would add a new level of complexity, which would create a corresponding increase in errors in reporting the tax to the Board. This increase in errors would complicate the Board’s administration of the sales and use tax laws.

COST ESTIMATE

Some costs would be incurred in notifying affected retailers, amending affected regulations to identify qualifying and nonqualifying equipment and machinery, verifying deductions on returns, and verifying claimed exemptions in audits. These costs are expected to be absorbable.

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REVENUE ESTIMATE

Background, Methodology, and Assumptions

This bill contains no definition of “farm equipment and machinery. For the purposes of this estimate, farm equipment and machinery is defined as farm tractors, implements of husbandry, irrigation equipment and any equipment added to a farm tractor or implement of husbandry that aids or enhances the performance of such tractor or implement.

In May 1997, the Far West Equipment Dealers Association (Far West) surveyed their California member dealers for sales of new and used farm equipment. Forty-eight dealers responded to the survey and reported sales of \$125.4 million. Expanding these amounts to all 124 California member dealers results in sales of new and used farm equipment of \$323.8 million.

The North American Equipment Dealers Association (NAEDA) has produced statistics showing that the average California farm equipment dealer has sales of new and used farm equipment amounting to \$4.7 million annually. There are 140 California dealers who are members of NAEDA. Expanding the average sales to all 140 dealers results in total sales of farm equipment of \$648 million. This study is based on a survey of 24 California dealers.

Far West believes that the NAEDA results are high due to the fact that the dealers included in that study were larger multi-store dealers and not representative of the whole market. Based on the results from the two studies mentioned above and discussions with Far West, farm equipment sales are estimated to be \$450 million annually.

Revenue Summary

The revenue impact of exempting the \$450 million in sales of farm equipment and machinery from the 5% state sales and use tax would be an annual state revenue loss of \$22.5 million.

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